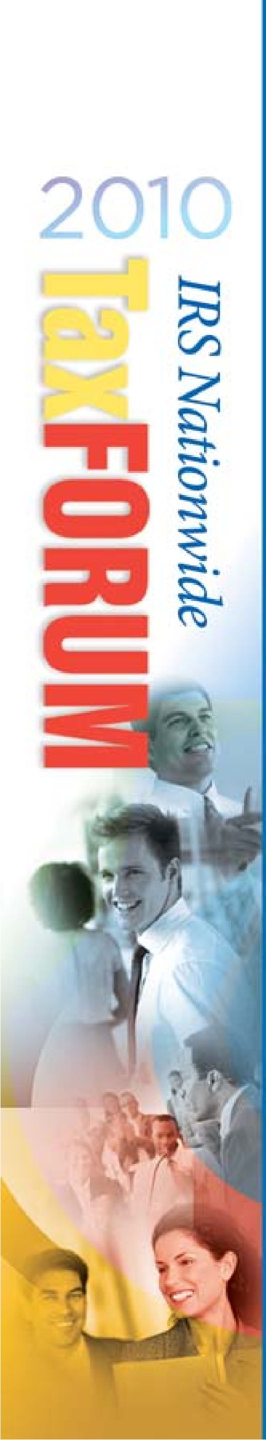

"Doing the D"
Reporting the Sale of Capital Assets

Presented by Claudia Hill, EA
or Frank Degen, EA

On behalf of NAEA

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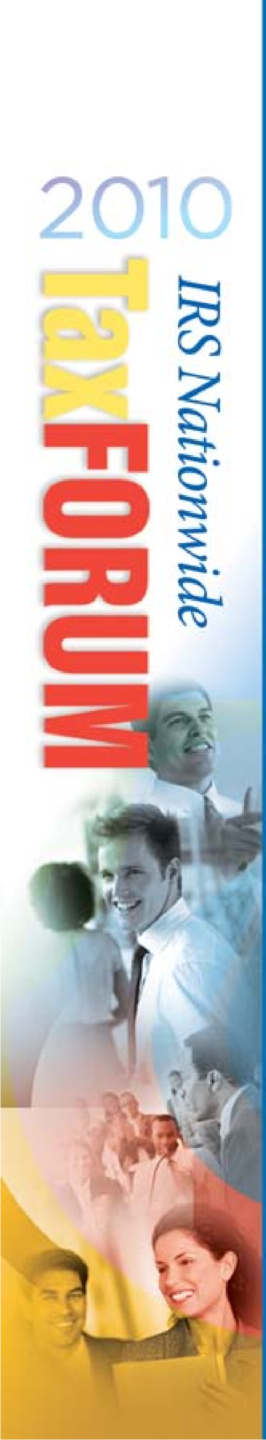

Capital Gains and Losses—10 Facts

1. Almost everything you own and use for personal purposes, pleasure or investment is a capital asset.

2. A capital gain (or capital loss) is calculated by subtracting your basis from the sales price.
   - NOTE: basis is usually your purchase price

3. You must report all capital gains & losses.

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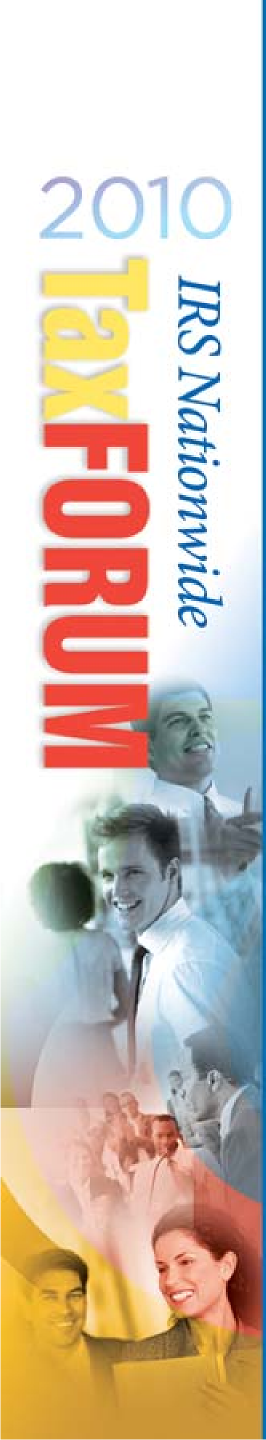

Capital Gains and Losses—10 Facts

4. You may deduct capital losses only on investment property, not on property held for personal use.

5. Capital gains and losses are characterized in two ways.
   - long- term (one year plus)
   - short-term (one year or less)

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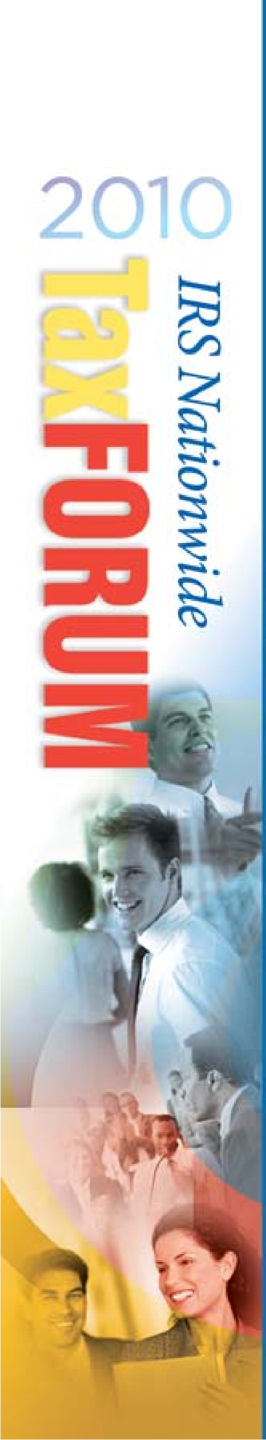

Capital Gains and Losses—10 Facts

6. For any given tax year your capital gains are calculated on a net basis; you must net your capital gains and losses.
   - net short term against short term
   - net long term against long term
   - if applicable, net the two

7. Capital gain tax rates are generally lower than the rates on other income.
   - 15% max capital gains rate for most people
   - 0% rate on some or all of lower income cap gain
   - 25% or 28% -special types capital gains

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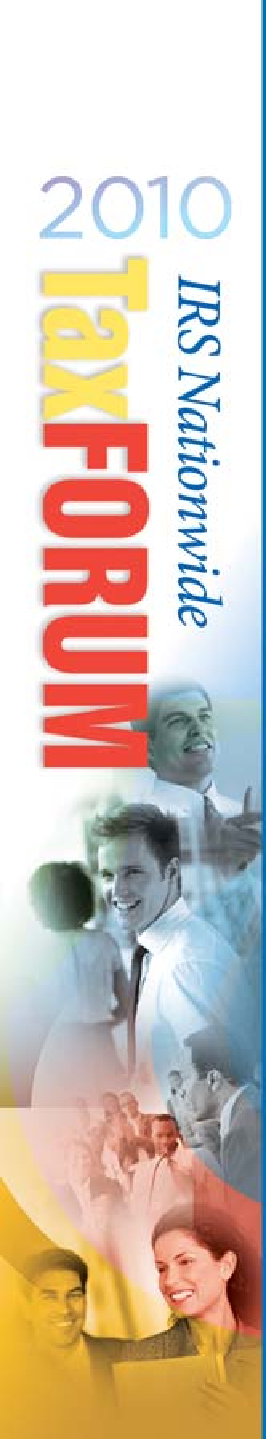
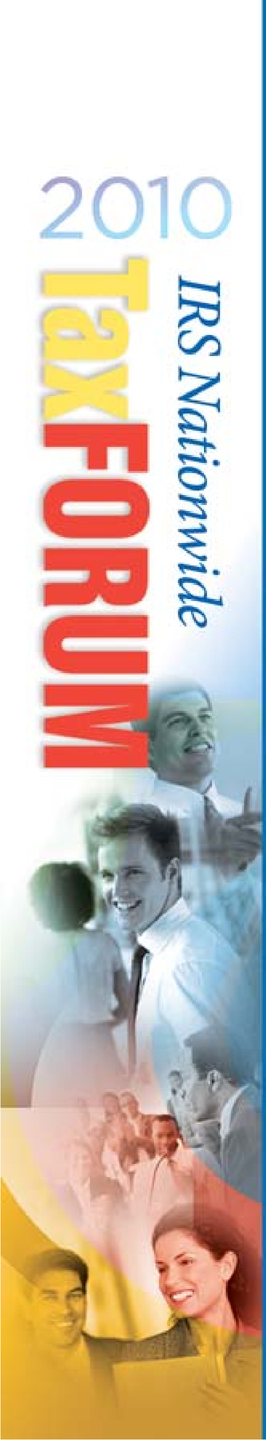


Capital Gains and Losses—10 Facts

8. The amount of ordinary income you may offset by any net capital loss is subject to an annual limit.
   - $3,000/$1,500 (if married filing separately)

9. If your total net capital loss is more than the yearly limit on capital loss deductions, you may carry forward the unused part.
   - Unused losses evaporate upon a taxpayer's death



Capital Gains and Losses—10 Facts

10. Capital gains and losses are reported on Schedule D (Capital Gains and Losses)
    - transferred to line 13 of Form 1040
    - <u>WARNING</u>: the biggest Schedule D challenge is clients who don't understand the importance of telling you about capital asset sales

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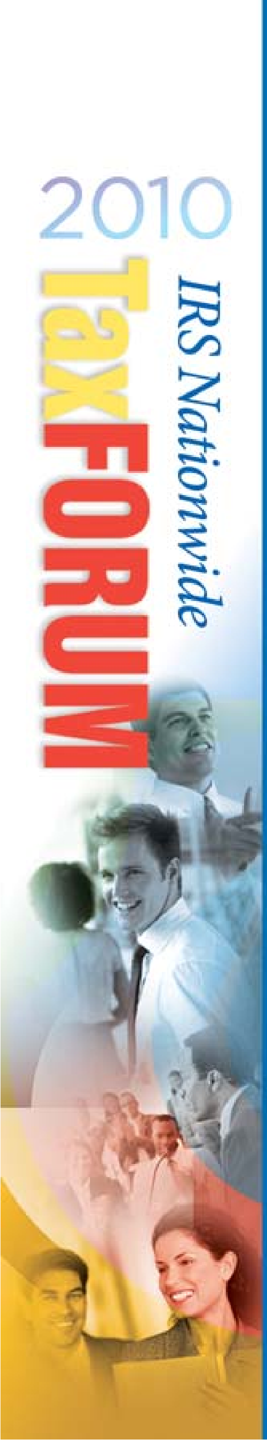
Timeout for a practical question

- If a taxpayer receives a Form 1099-B where gross proceeds exceed the gross income filing threshold, must he/she file a federal tax return?
    - EXAMPLE: taxpayer receives Form 1099-B for $100k gross proceeds of a stock sale. This is the taxpayer's only income for the year. The taxpayer's stock basis is $97k.



Gain or Loss?

- The difference between the amount for which you sell the capital asset and your basis is a capital gain or a capital loss.

- Gain or loss—the transaction needs to be reported.

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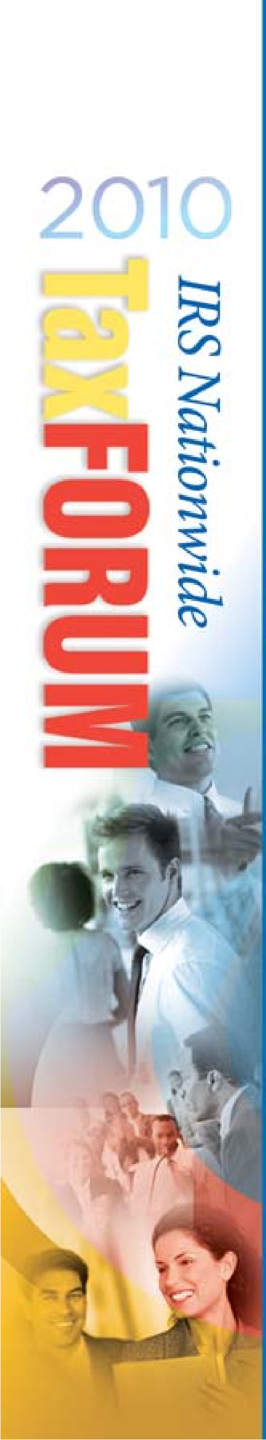

Basis

- You must keep accurate records that show your basis.

- Your records should show
  - purchase price, including commissions
  - increases to basis, such as the cost of improvements or reinvested dividends
  - decreases to basis, such as depreciation, non-dividend distributions on stock, and stock splits.

- Special basis rules for gifts and inheritances

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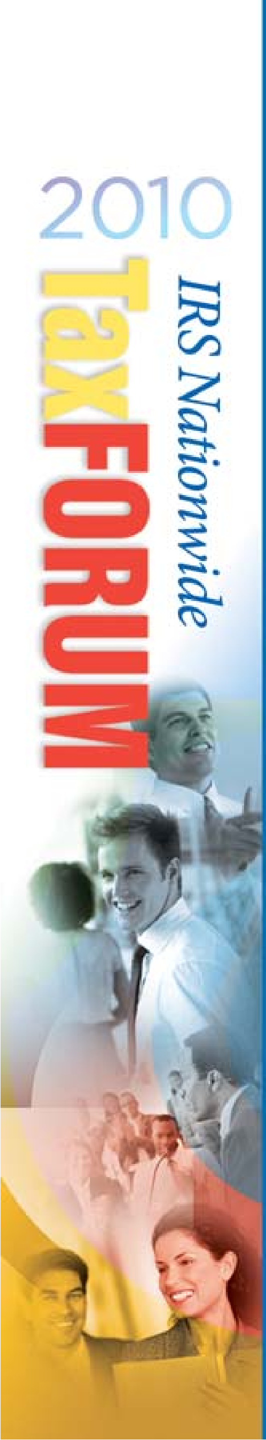

Gains and losses are netted

- Net gains & losses by category/subcategory:
  - short against short
  - long against long
- Net short losses then offset long sequentially

      28%

                    25%

                              15% or 0%

- Net long losses offset in reverse order.

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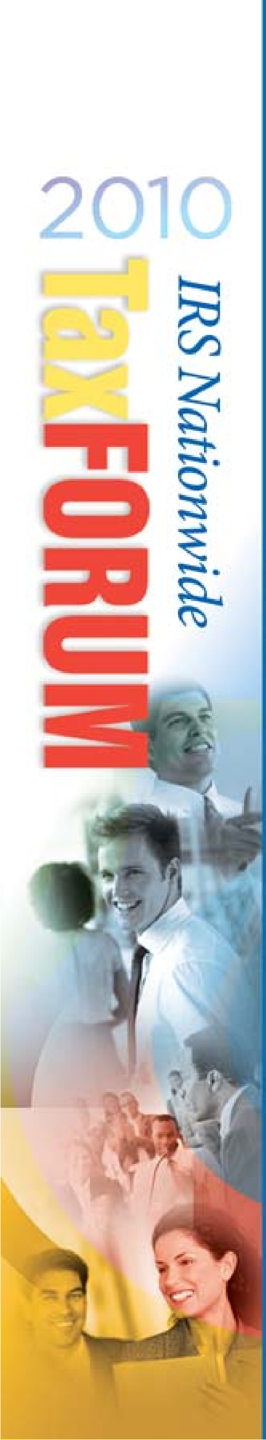

Unused, Excess Capital Loss Carryover

- Losses Retain Character

- Short-Term Losses Used First

- Carryover Losses Must Be Used in Succeeding Year

- Carryover Losses are Lost When Taxpayer Dies

- Carryover Computation

  - *the net capital loss must be reduced by the lesser of:*

    1) the amount of capital loss that is allowed as a deduction for the taxable year; or

    2) the taxpayer's "adjusted taxable income" for the taxable year

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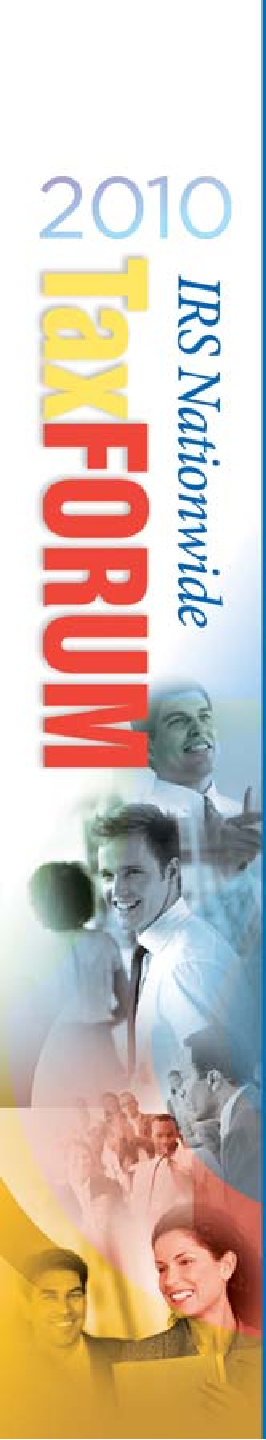

Some fundamental rules…

- The loss must be *realized* to be *recognized*.
- The loss must be *recognized* when *realized*.
- Losses from personal-use assets are not deductible.
- Legitimate non-business bad debts are treated as short-term capital losses.

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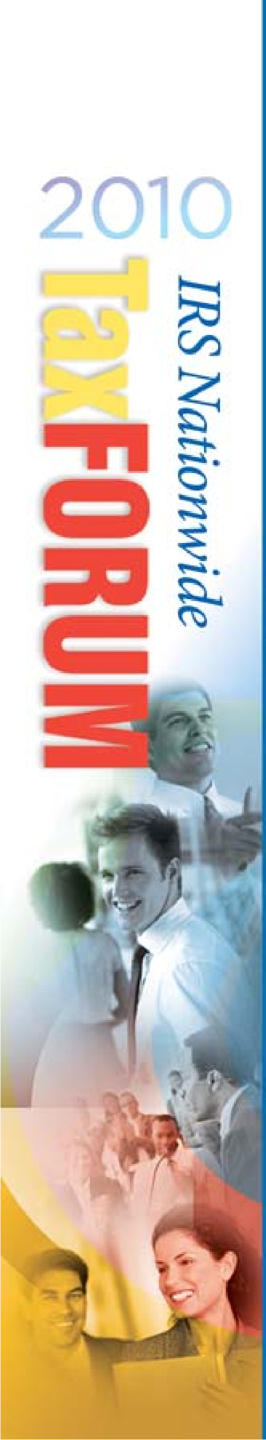

Special Situations

- Non-business bad debt
- Worthless securities
- Filing a claim for refund
- Sale of home

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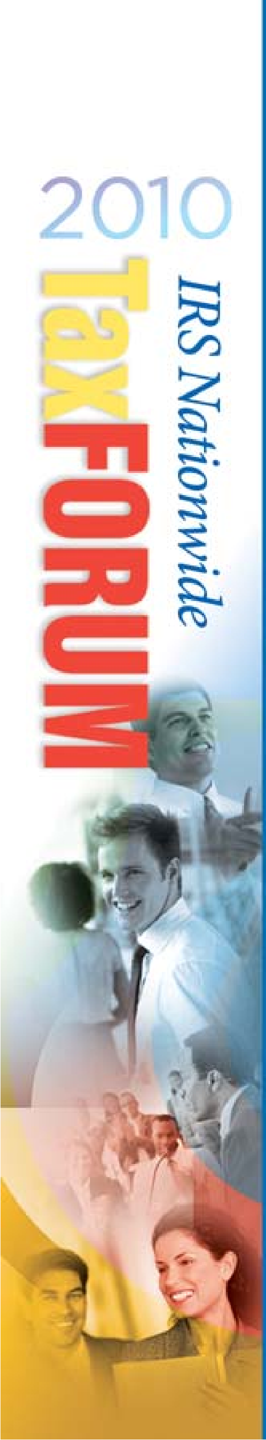
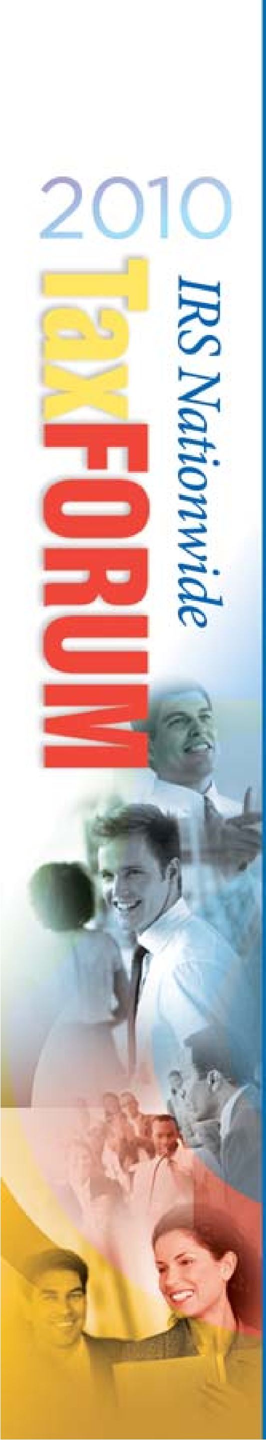


Special Situations

- **Non-business bad debts**
  - You must establish both:
    - you have taken reasonable steps to collect the debt; and,
    - the debt is totally worthless.
  - Take the deduction only in the year the debt becomes worthless.
  - Deduct as a short-term capital loss on Schedule D
  - CAUTION: non-business bad debts between family members raises IRS question—is it a gift or loan?



Special Situations

- **Worthless securities**
  - A loss from worthless securities is treated as a loss from the sale or exchange of a capital asset on the last day of the tax year.
  - The loss deduction for worthless securities must be taken for the tax year in which the securities became worthless.
  - *How do you know it is worthless?*

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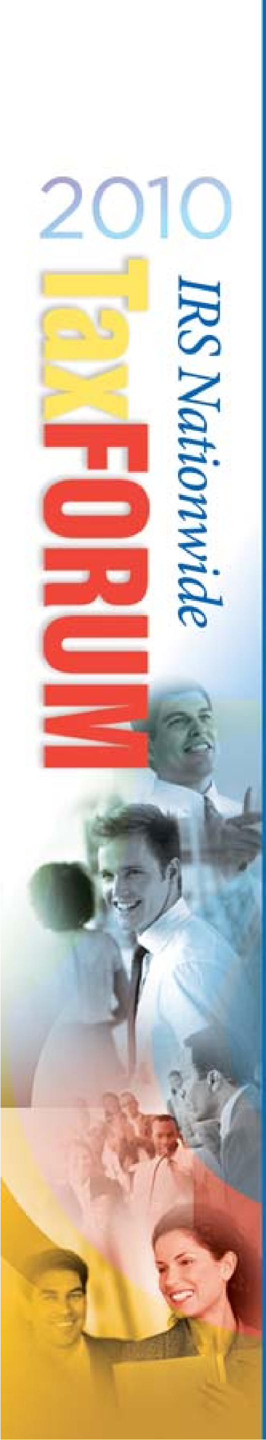

Special Situations

- **Non-business bad debts & worthless securities - Filing a claim for refund**
  - If you do not deduct a bad debt or worthless security on your original return for the year it becomes worthless, you may file a claim for a credit or refund to reflect the loss.
  - Use Form 1040X.
  - You must file it within 7 years from the date your original return for that year had to be filed, or 2 years from the date you paid the tax, whichever is later.

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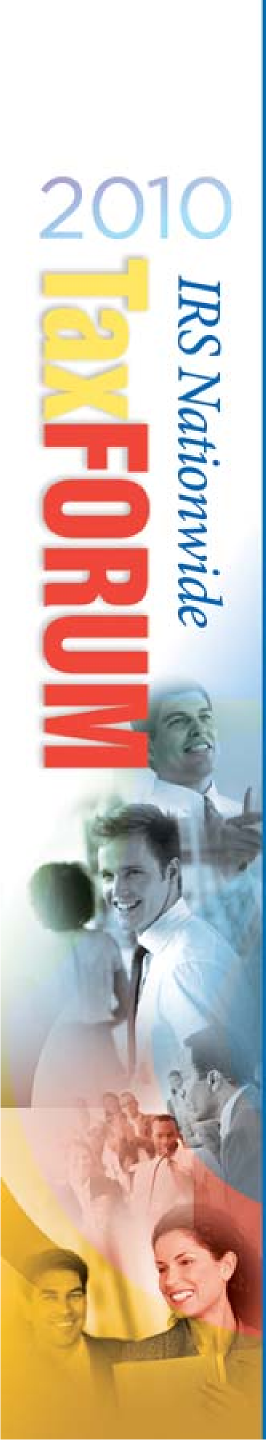
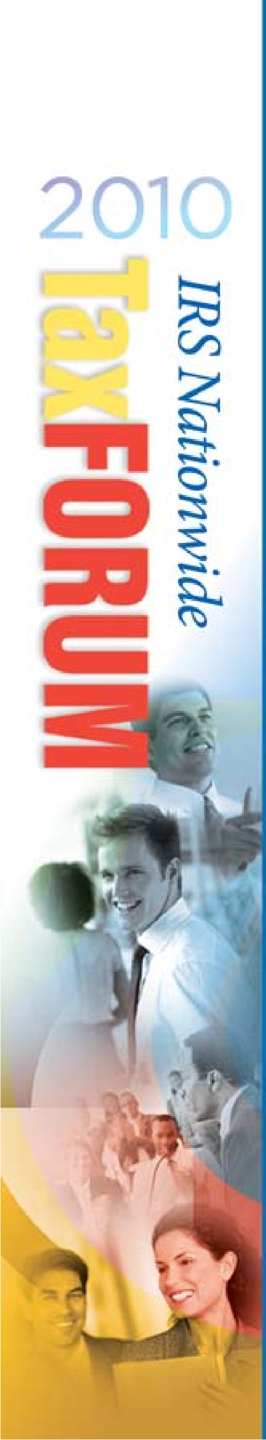


Special Situations

- **Sale of Home**
  - Gain in excess of any amount excludable is taxed as a capital gain.
  - Losses are not deductible
  - Watch for special situations

    conversion from rental to personal use & vice versa
  - CAUTION: If a sold residence qualified for a federal or state homebuyer credit when purchased, then recapture of the credit may be required.



Resource References

- www.IRS.gov (forms, calculations, addresses, online application, etc.)
- Publication 544, Sales and Other Dispositions of Assets; Publication 550, Investment Income and Expenses; and Publication 564, Mutual Fund Distributions.

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